WILTSHIRE COUNCIL

WILTSHIRE PENSION FUND COMMITTEE

1 DECEMBER 2011

GOVERNMENT CONSULTATION ON PROPOSED INCREASES TO EMPLOYEE CONTRIBUTION RATES & PUBLIC PENSIONS REFORM UPDATE

Purpose of the Report

1. The purpose of this report is to update the Committee on the recent developments in the proposed changes to the Local Government Pension Scheme (LGPS) and to present a draft response to the Communities & Local Government (CLG) consultation on proposed increases and changes to the scheme accrual rates effective from 1 April 2012 for members' consideration.

Background

2. The Local Government Pension Scheme (LGPS) is facing significant changes over the next few years. There are a number of different proposals being considered but nothing has yet been adopted or agreed by the Government.

3. The changes facing the LGPS can be split into two phases:

    - Phase 1 is the short term proposals to save £900m per annum across all LGPS Fund by 2015; and

    - Phase 2 is the reforming of public sector pensions nationally based on the recommendations of the Hutton report to make them sustainable in the longer term that is due to come into place from April 2015 onwards.

Considerations for the Committee

Phase 1: Consultation on contribution increases for the LGPS

4. At the Spending Review in October 2010 the Chancellor announced that employee contributions to the LGPS would be increased in order to deliver short term cost savings of £900m per annum by 2014-15, equivalent to 3.2% of pay on average. These increases, which are to be phased in from April 2012, will also apply to the unfunded public sector schemes. However, the Government has since accepted that the funded LGPS can be treated differently and can use alternative ways to deliver the savings.

5. On 20 July 2011 the Secretary of State for the CLG invited the Local Government Group (LGG) and the local authority Trade Unions to propose their preferred approach to delivering the required cost savings by 2014-15. The LGG submitted a set of proposals to CLG on 21 September 2011 although these did not have the support of the Trade Unions. On 7 October 2011, CLG published a number of options for consultation. The closing date for response is 6 January 2012.

The Proposals

6. The consultation letter can be found in Appendix A. CLG have put forward two options to deliver the £900m per annum cost savings by 2014-15. This partially reflects the Government's previously stated aims of protecting low earners, with no increases in the employee contributions for those earning less than £15,000 on a full time equivalent basis and increases limited to 1.5% of pay by 2014-15 for those earning up to £21,000. In addition, higher earners pay progressively more reflecting their higher pensions although increases should be capped at 6% of pay.

7. Rather than making all the savings by increasing contributions (subject to the above constraints), CLG has proposed smaller increases in employee contributions combined with reductions in benefits:

Option 1:

- A phased increase in employee contributions from April 2012 to deliver £450m savings, equivalent to 1.5% increase in pensionable pay by 2014-2015. Detailed in the table below.

Tariff Band	Current	2012/13	2013/14	2014/15
£0 - £12,900	5.5%	5.5% (0.0%)	5.5% (0.0%)	5.5% (0.0%)
£12,901- £15,100	5.8%	5.8% (0.0%)	5.8% (0.0%)	5.8% (0.0%)
£15,101- £19,400	5.9%	5.9% (0.0%)	6.0% (0.1%)	6.0% (0.1%)
£19,401- £21,000	6.5%	6.7% (0.2%)	7.2% (0.7%)	7.7% (1.2%)
£21,001- £32,400	6.5%	7.2% (0.7%)	8.0% (1.5%)	8.3% (1.8%)
£32,401- £43,300	6.8%	7.5% (0.7%)	8.3% (1.5%)	8.7% (1.9%)
£43,301- £60,000	7.2%	8.2% (1.0%)	8.7% (1.5%)	9.0% (1.8%)
£60,001- £81,100	7.2%	8.7% (1.5%)	9.2% (2.0%)	10.0% (2.8%)
£81,101- £100,000	7.5%	9.0% (1.5%)	9.8% (2.3%)	11.0% (3.5%)
£100,001- £150,000	7.5%	9.5% (2.0%)	11.0% (3.5%)	12.0% (4.5%)
£150,001 +	7.5%	10.0% (2.5%)	12.0% (4.5%)	12.5% (5.0%)

- A further £450m per annum to be achieved through a stepped reduction in the scheme's accrual rate from the current 1/60th to 1/64th in 2013-14 and 1/65th from April 2014. This change will of course impact all scheme members (including the lower paid).

Option 2:

- A lower phased increase in employee contributions from April 2012 to deliver £300m savings, equivalent to 1% increase in pensionable pay by 2014-15. Detailed in the table below.

Tariff Band	Current	2012/13	2013/14	2014/15
£0 - £12,900	5.5%	5.5% (0.0%)	5.5% (0.0%)	5.5% (0.0%)
£12,901- £15,100	5.8%	5.8% (0.0%)	5.8% (0.0%)	5.8% (0.0%)
£15,101- £19,400	5.9%	5.9% (0.0%)	6.0% (0.1%)	6.0% (0.1%)
£19,401- £21,000	6.5%	6.5% (0.0%)	6.8% (0.3%)	6.8% (0.3%)
£21,001- £32,400	6.5%	6.8% (0.3%)	7.2% (0.7%)	7.5% (1.0%)
£32,401- £43,300	6.8%	7.1% (0.3%)	7.8% (1.0%)	8.2% (1.4%)

£43,301- £60,000	7.2%	7.8% (0.6%)	8.4% (1.2%)	8.8% (1.6%)
£60,001- £81,100	7.2%	8.7% (1.5%)	8.8% (1.6%)	9.5% (2.3%)
£81,101- £100,000	7.5%	9.0% (1.5%)	9.8% (2.3%)	10.5% (3.0%)
£100,001- £150,000	7.5%	9.3% (1.8%)	10.8% (3.3%)	11.5% (4.0%)
£150,001 +	7.5%	9.5% (2.0%)	11.8% (4.3%)	12.5% (5.0%)

- Further savings of £600m per annum to be raised by a larger reduction in accrual rate from the current 1/60th currently to 1/67th from April 2014. Again, this change will of course impact all scheme members (including the lower paid).

8. The consultation document also mentions the option to increase retirement age – in combination with changes to the accrual rate and / or employees' contributions. The Government Actuary's Department has calculated that setting the LGPS normal pension age equal to the State Pension Age (SPA) would deliver annual savings of £330m if implemented for future service accruals. The LGG proposals are also included as an option.

9. Finally, the consultation proposes a technical amendment to the regulations to allow a downward revision of employer contributions rates between the three yearly actuarial valuations. This would allow employers to benefit from any savings achieved once the scheme amendments are introduced. However, doing this would require careful consideration.

Local Governments Group Proposal

10. The LGG proposed (see Annex B of Appendix A) that the first £300m of the £900m savings required by the Government should be met from an increase in the scheme's normal retirement age from 65 to 66 for benefits earned from April 2014.

11. They suggest that the remaining £600m could be met by offering employees earning more than £15,000 a choice between:

    - an increase in their contribution rates (1.5% for those earning £15k-£21k and between 2-2.5% for those above £21k), or

    - a worsening in the accrual rates from April 2014.

12. In addition, the LGG propose that employees earning less than £15,000 could be given the option of reducing their existing contribution rates in return for a worsened accrual rate.

CLG's Consultation Questions

13. The consultation paper invites responses to the following questions:

- **Question 1** – Do the proposals meet the policy and objectives to deliver the necessary level of savings?

- **Question 2** – Are there any consequences or aspects of the proposals that have not been fully addressed?

- **Question 3** – Is there a tariff of alternative measures which consultees think would help to further minimise any opt outs from the scheme?

- **Question 4** – Are there equality issues that could result in any individual groups being disproportionately affected by the proposals? If so, what are considered to be the nature and scale of that disproportionate effect? What remedies would you suggest?

- **Question 5** – Within the consultation period, consultees' views are invited on the prospects of introducing into the LGPS a link with the state pension age as recommended to the Government in Lord Hutton's report.

Views of the Wiltshire Pension Fund

14. Any proposals that avoid the full 3.2% average increase in employee contributions by 2014-15 are supported as this should reduce the number of people opting out. Although the reductions in benefits are not ideal they may be unavoidable in order to minimise contribution increases and keep members in the scheme.

15. It would have been ideal if the Government brought forward its proposed post Hutton changes to enable implementation a year earlier, i.e. 2014-15 instead of 2015-16. It is anticipated these changes would achieve the required £900m savings as a minimum. It would also be a simpler message to communicate and from an administration viewpoint only involve a single change.

16. If the above is not achievable, then the next preferred option would be keeping contribution levels to a minimum by reducing the accrual rate. From the data extrapolated in the CLG consultation, it suggests the required savings could be achieved by reducing the accrual rate from 1/60th to 1/70th in 2014-15 and not increasing contribution rates. This would be extremely straightforward to implement, while helping the membership in not having to find additional money to pay increases in contributions. However, CLG have indicated this option could be unpalatable for the Government if the rest of the Public Services are facing an increase. Nevertheless, looking at the employee contribution rates across the sector the LGPS are already, in most cases, paying higher rates and retire later.

17. If employee contribution rate increases are mandatory in the short term then option 2 of the CLG's proposal would be the next preferred option. This proposes the lowest increase in employee contributions and requires only one change in the accrual rate.

18. There are genuine concern over the potential complexity for members. If CLG's proposals are adopted, many members would end up with pre-2008, post-2008, post-2012 and post-Hutton benefits which could all have different accrual rates and retirement ages. If the LGG proposal was adopted these complications would be increased further by members' ability to pay lower contributions for a lower accrual rate and vice versa.

19. The biggest challenge will be the communication to members. If the changes are not fully understood (or straight forward to explain) it could lead to members making uninformed decisions and may lead to higher opt out rates.

20. The CLG proposals will put additional strain on administration. Funds currently not only have to implement these short term changes in contributions and accrual rates, but have auto-enrolment and the post Hutton reforms in 2015 to contend with. However, a more immediate problem is the impact on employers payroll teams as the CLG proposals increase the members' contribution salary bandings from the current 7 to 11 by April 2012. Even if CLG announce these changes as soon as the consultation period ends in January 2012 it leaves a maximum of 2 months for all payroll providers to implement this change. The Fund's view is a lead time of at least 12 months is more reasonable and

would request that if the bandings have to increase then this takes place from April 2013 at the earliest.

21. To maintain simplicity it would be ideal for members and administrators if any changes proposed could at least dovetail as closely as possible with the post-Hutton (phase 2) reforms, i.e. in terms of contribution rates, accrual rates and retirement ages.

22. Although the CLG's proposals might allow reductions in employer rates prior to the 2013 valuations to reflect increases in employee contributions and / or reductions of benefits, discussions would need to take place with the actuary before doing so. The Fund already employs a stabilisation policy so contribution rates are currently below their theoretical rates. Also considering the current market conditions the case for doing this would remain weak.

23. The Fund has asked employers and its members for their views on the consultation although to date only one member's comments have been received.

24. Appendix B shows the proposed draft response to the consultation for consideration by this Committee.

Phase 2: Government Proposals for Reformed Public Services Schemes

25. On 2 November 2011 the Chief Secretary to the Treasury made a ministerial statement updating Parliament on the reform of public service pensions. Included in the statement was a new offer for consideration by the Trades Unions during the ongoing negotiations on public service pension reform. However, the Government said the offer was conditional dependent upon reaching agreement by the end of the year.

Proposals

26. The Government's proposals for preferred scheme design are the basis for the current reforms of both the unfunded schemes and the LGPS. The proposed scheme (known as the "Reference Scheme") is consistent with Lord Hutton's recommendations published in March 2011 and with government announcements since then.

27. The main features are therefore no surprise. It is understood that there are two significant changes from the "Reference Scheme" proposed earlier in October - a more generous accrual rate and the introduction of transitional protections for those close to retirement. The main features of the new scheme design are as follows:

- Defined benefit scheme
- Career average re-valued earnings (CARE) design
- Accrued benefits remain protected with a final salary link when benefits are taken
- A new accrual rate of 1/60th, an increase of 8% on the previously proposed 1/65th
- Revaluation of accrued benefits in line with earnings increases and benefits increase in line with price inflation (CPI)
- Normal retirement age (NRA) will be linked to State Pension Age
- For those within 10 years of their current NRA (determined from 1 April 2012) there will be no change to when they can retire nor any decrease in the pension benefits from the current scheme. How this is introduced will be subject to negotiation within overall cost constraints.
- Members will not be forced to work longer. They will have a choice when to retire (in some cases subject to an appropriate adjustment) and some will be covered through the protections set out above.

- Pension reforms will come in from 2015

28. The Government also confirmed that the reference scheme is based on the employee contributions which include the planned 3.2% of pay per annum average increase from 2015 for the purposes of delivering short term cost savings. As the LGPS has also retained the flexibility to deliver £900m per annum cost savings by 2015 through a combination of lower employee contribution increases and benefit changes (see consultation above in Phase 1) the final agreed scheme may look somewhat different.

29. The Government's paper also included details of scheme-specific "cost ceilings"- a total employer and employee contribution rate benchmark for the purpose of determining future scheme design.

30. The "cost ceiling" calculated by the Government Actuary's Department is the future service contribution rate required to deliver the "Reference Scheme" benefits based on the Treasury's financial assumptions and scheme specific data and demographic assumptions. It is understood that the cost ceilings published are higher than the previous cost ceilings used in discussions with unions from early October. The change in the cost ceilings reflects the more generous terms in the latest Reference Scheme design.

31. The gross cost ceiling for the LGPS was 17.3% after adjustment for the lower proposed increase to average LGPS employee contributions. This has now been increased to 20.4% to reflect the improved benefits and assumes an increase in employee contribution of 3%. It could be reduced at a later stage depending on the employee contribution increase coming out of the current consultation

32. The Government argues its revised offer is sustainable, affordable and fair to both taxpayers and scheme members over the long term. It also argues that the improved accrual rate, new transitional protections and corresponding increases in the cost ceiling should be sufficient to allow agreement with the unions. However, it does say these proposals are conditional on agreement being reached by the end of 2011 in scheme by scheme talks.

33. The Government's latest proposal confirms the retention of very good quality pensions for public service workers and offers complete protection (including future service benefits) for those currently within a decade of retirement. The latter is a new development and goes beyond what Lord Hutton proposed.

34. A key element of the reforms all along has been to ensure that public service workers still receive good quality pensions, but also that the cost of these pensions remains affordable for the State at a time when life expectancy continues to accelerate. These were the principles laid out by Lord Hutton in his original report, and have formed the basis for the proposals ever since. The Government's latest proposals recognise these factors.

35. A later retirement age appears unavoidable at a time when life expectancy is increasing by at least two years per decade. For these proposals to stand a chance of being sustainable it is critical that State Pension Age moves at a realistic rate to keep pace with improvements in life expectancy.

36. Unlike the unfunded schemes, the funded LGPS has the option of alternatives to a 3.2% increase in contributions such as smaller contribution increases combined with accrual rate reductions. Therefore there remains a case for a lower accrual rate and lower employee contributions to keep more people in the scheme. However, dovetailing short

and long term changes to minimise complexity for administration and members should be a primary objective.

Environmental Impact of the Proposal

37. There is no environmental impact of this proposal.

Financial Considerations & Risk Assessment

38. The financial considerations are discussed above.

39. The changes to the scheme will impact on the following risks which are reported elsewhere on this agenda.

40. **PEN003 Insufficient Funds to meet liabilities as they fall due**: increases in employee contributions or changes in benefits may lead to an increase in opt-outs and reducing income levels resulting in the Fund needing to review its investment strategy to use investment income to pay benefits. Further modelling is required to understand this impact when scheme changes have been finalised.

41. **PEN006 Significant rises in employer contributions for employers due to increase in liabilities**: Changes to the scheme will impact on the future service cost in pensions. This wont be known until the scheme detail is agreed.

42. **PEN013 Failure to Communicate properly with stakeholders**: Changes need to be careful communicated to members to ensure they have the relevant information to make informed decisions. The Fund is currently keeping employers updated of the changes for disseminating to staff and a programme of pension clinics and presentations are being undertaken to reduce this risk.

Reasons for Proposals

43. It is best practice to submit a response in relation to consultations.

Proposals

44. The Committee is asked to note the pensions reforms update and approve the draft response to the CLG consultation on the proposed increases and changes to the scheme accrual rates effective from 1 April 2012 as shown in Appendix B.

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Unpublished documents relied upon in the production of this report:

Hymans Robertson Consultation *on contribution increases for the LGPS* October 2011

Hymans Robertson *Government Proposals for Reformed Public Services Schemes* November 2011